

PERAC AUDIT REPORT



PRIM Contributory Retirement System

JAN. 1, 2000 - DEC. 31, 2004 / PERAC 04: 10-107-07



TABLE OF CONTENTS

Letter from the Executive Director.....	1
Explanation of Findings and Recommendations.....	2
Statement of Pooled Net Assets.....	4
Statement of Changes in Pooled Net Assets.....	5
Notes to Financial Statements.....	6

PERAC

COMMONWEALTH OF MASSACHUSETTS | PUBLIC EMPLOYEE RETIREMENT ADMINISTRATION COMMISSION

DOMENIC J. F. RUSSO, *Chairman* | A. JOSEPH DeNUCCI, *Vice Chairman*

JOSEPH E. CONNARTON, *Executive Director*

HENRY G. BRAUER | KENNETH J. DONNELLY | JAMES M. MACHADO | DONALD R. MARQUIS | THOMAS TRIMARCO

February 27, 2006

The Public Employee Retirement Administration Commission has completed an examination of the Pension Reserves Investment Management Board pursuant to G. L. c. 32, § 21. The examination covered the period from July 1, 2000 to June 30, 2004. This audit was conducted in accordance with the accounting and management standards established by the Public Employee Retirement Administration Commission in regulation 840 CMR 25.00.

In our opinion, the financial records are being maintained and the management functions are being performed in conformity with the standards established by the Public Employee Retirement Administration Commission with the exception of those noted in the findings presented in this report.

We commend the Pension Reserves Investment Management Board for the exemplary operation of the system.

In closing, I acknowledge the work of examiners James Sweeney and James Tivnan who conducted this examination, and express appreciation to the PRIM Board, the Executive Director, and the Board staff for their courtesy and cooperation.

Sincerely,



Joseph E. Connarton
Executive Director



Pension Reserves Investment Management Board

Explanation of Findings and Recommendations

FOR THE FOUR YEAR PERIOD ENDING JUNE 30, 2004

1. Compliance with Open Meeting Law for Advisory Committees.

Meetings of the Pension Reserves Investment Management Board are open to the public, are listed in advance by public notice and minutes are kept in sufficient detail. Interested parties are encouraged to attend. The Board organized a number of advisory committees whose membership includes both board members and non-member persons selected based on their qualifications and professional expertise. Such committees have consisted of an audit committee, an investment committee, an administration committee and a real estate committee. Meetings of these committees are considered private and confidential and not subject to the requirements of the Commonwealths Open Meeting Law. No formal votes are taken and no final decisions are made at such committee meetings. Minutes are not kept. The Board initially requested an opinion from the Office of the Attorney General of the Commonwealth in correspondence dated July 10, 2002. They subsequently solicited a formal written opinion in a follow up letter dated October 25, 2002. The Attorney General has not formally responded to this issue.

Recommendation: Massachusetts General Laws Chapter 30A pertaining to Open Meetings defines in rather broad terms what kinds of governmental bodies are subject to Open Meeting requirements. A state board or subdivision, including a committee or subcommittee of that board is specifically mentioned.

Chapter 30A: Section 11A 1/2 Open meetings of governmental bodies

Section 11A1/2. All meetings of a governmental body shall be open to the public and any person shall be permitted to attend any meeting except as otherwise provided by this section. A governmental body shall maintain accurate records of its meetings, setting forth the date, time, place, and members present or absent and action taken at each meeting, including executive sessions.

In the absence of any formal opinion rendered by the Attorney General, we recommend the Pension Reserves Investment Management Board comply with all provisions of Chapter 30A relating to open meetings of all advisory committees and subcommittees. The Board should again solicit the Attorney General for an opinion as to whether the advisory committee meetings are subject to the Open Meeting Statutes.

Board Response:

As reflected in the PRIM Board's correspondence to the Office of the Attorney General, both on July 10, 2002 and October 25, 2002, the PRIM Board and Staff are of the opinion that PRIM's Advisory Committee meetings do not fall under the requirements of the Open Meeting Laws. Additionally, on August 8, 2002, a proposed motion "that the PRIM Board post all Advisory Committee Meetings until PRIM has a written opinion from the Attorney General's Office" failed, therefore, PRIM continues to handle the Advisory Committee Meetings as not being subject the Public Meetings law as it has consistently since 1985.

On November 29, 2005, Michael Travaglini contacted the Office of the Attorney General's Office to obtain a status on PRIM's pending request for an opinion.

Pension Reserves Investment Management Board

Explanation of Findings and Recommendations (Continued)

FOR THE FOUR YEAR PERIOD ENDING JUNE 30, 2004

2. Revise or Amend Operating Trust.

Section 9.9 of the Operating Trust Agreement, states that an Annual Report should be filed on or before May 1st, with the clerks of the House and Senate, on a form prescribed by PERAC, as of December 31st of the previous year. The Pension Reserves Investment Trust Fund reports extensively on its financial results of operations primarily on a fiscal year basis (July-June) coinciding with other component units of the Commonwealth of Massachusetts.

Recommendation: The Pension Reserves Investment Management Board should initiate action to revise or amend Section 9.9 of the Operating Trust Agreement to reflect the actual financial reporting requirements of their stewardship.

Board Response:

PRIM agrees with PERAC's recommendation, however, upon further review, PRIM Staff noted that Section 9.9 of the PRIT Operating Trust Agreement reflects the requirements outlined in Chapter 32, Sec 23 (2A)(d) as stated below:

“(d) The PRIM board shall annually on or before May first, file with the clerk of the house of representatives and with the secretary of the retirement board of each system which is a participant in said fund, on a form prescribed by the commission, a sworn statement of the financial condition of said fund as of December thirty-first the previous year. The commission may for cause shown extend the time for filing any such statement.”

The PRIM Board does not have the authority to initiate legislation. PRIM Staff would be happy to work with PERAC to author a change in Chap 32, Sec 23 to reflect the actual reporting requirements of the PRIT Fund. Upon changes to the legislation, PRIM will initiate action to amend Section 9.9 of the Operating Trust Agreement.

Final determination

PERAC audit staff will follow-up in six (6) months to ensure appropriate actions have been taken regarding all findings.

Pension Reserves Investment Trust Fund

STATEMENT OF POOLED NET ASSETS

FOR THE FOUR YEAR PERIOD ENDING JUNE 30, 2004

(000 Omitted)

	FOR THE PERIOD ENDING JUNE 30,	
ASSETS	2004	2003
Cash	\$61,812	\$53,091
Short Term Investments	1,913,623	725,211
Fixed Income Securities	7,674,248	6,967,167
Equities	18,043,835	17,204,880
Real Estate	2,774,674	1,895,280
Timber	930,596	506,949
Alternative Investments	1,791,526	1,523,122
Interest and Dividends Receivable	114,367	101,877
Receivable for Investments Sold	607,807	54,647
Securities Sold on a When-issued Basis	83,771	295,009
Unrealized Gains on Foreign Exchange Contracts	2,257	2,818
Receivable from Health Care Security Trust	5,410	2,425
Margin Variation Receivable	<u>8,214</u>	<u>-</u>
Total Assets	\$34,012,139	\$29,332,476
LIABILITIES		
Securities Purchased on a When-issued Basis	\$274,880	864,622
Payable for Investments Purchased	91,742	101,564
Unrealized Losses on Foreign Exchange Contracts	9,606	408,416
Obligation Under Securities Lending Transactions	943,772	3,268
Margin Variation Payable	-	464
Management Fees Payable to PRIM	<u>52,140</u>	<u>60,064</u>
Total Liabilities	\$1,372,139	\$1,438,397
Net Assets Held in Trust for Pool Participants	<u>\$32,640,000</u>	<u>\$27,894,079</u>

Note: Financials for 2001 and 2002 available upon request

Pension Reserves Investment Trust Fund

STATEMENT OF CHANGES IN POOLED NET ASSETS

FOR THE FOUR YEAR PERIOD ENDING JUNE 30, 2004

(000 Omitted)

	FOR THE PERIOD ENDING JUNE 30,	
Additions	2004	2003
Contributions:		
State Employees	\$362,309	\$350,705
State Teachers	522,133	504,014
Other Participants	<u>257,892</u>	<u>136,712</u>
Total Contributions	<u>\$1,142,335</u>	<u>\$991,432</u>
Net Investment Income		
From Investment Activities:		
Net Realized Gain (loss) on Investments and Foreign Currency Transactions	1,838,578	(647,292)
Net Change in Unrealized Appreciation on Investments and Foreign Currency Translations	2,618,402	813,384
Interest Income	371,335	392,272
Dividend Income	363,012	298,048
Real Estate Income, net	144,492	121,925
Timber Income, net	28,615	12,415
Alternative Investment Income, net	<u>14,656</u>	<u>6,083</u>
Sub Total	<u>\$5,379,090</u>	<u>\$996,835</u>
Management Fees	<u>(72,649)</u>	<u>(58,523)</u>
Net Income from Investment Activity	<u>\$5,306,440</u>	<u>\$938,312</u>
From Securities Lending Activities		
Securities Lending Income	9,629	12,267
Securities Lending Expense	(7,001)	(3,040)
Net Income from Security Lending	<u>\$2,628</u>	<u>\$9,227</u>
Total Net Investment Income	<u>\$5,309,068</u>	<u>\$947,539</u>
Total Additions	<u>\$6,451,403</u>	<u>\$1,938,971</u>
Deductions:		
Redemptions:		
State Employees	852,702	636,742
State Teachers	768,153	631,980
Other Participants	<u>84,627</u>	<u>60,604</u>
Total Deductions	<u>1,705,482</u>	<u>1,329,326</u>
Net Increase in Pooled Net Assets	<u>\$4,745,921</u>	<u>\$609,646</u>
Net Assets Held in Trust for Pool Participants		
Balance, beginning of year	<u>27,894,079</u>	<u>27,284,433</u>
Balance, end of year	<u>\$32,640,000</u>	<u>\$27,894,079</u>

Pension Reserves Investment Management Board

NOTES TO FINANCIAL STATEMENTS

FOR THE FOUR YEAR PERIOD ENDING JUNE 30, 2004

PRIM/PRIT Fund Overview

The Pension Reserves Investment Management ("PRIM") Board was created by an act of the state legislature in 1983 (Chapter 661 of the Acts of 1983). PRIM is a nine-member board which includes statutorily designated appointments of the governor and state treasurer, as well as elected members of the system. The state Treasurer serves as its chair. The Board is charged with the general supervision of the Pension Reserves Investment Trust Fund, which was established by the same act of the legislature in 1983, and is governed by a declaration of trust adopted by the Board and subject to approval of the legislature.

The PRIT Fund is a pooled investment fund established to invest the assets of the Massachusetts State Teachers' and Employees' Retirement Systems, and the assets of county, authority, district, and municipal retirement systems that choose to invest in the PRIT Fund. The PRIT Fund was created by the Legislature in December 1983 (Chapter 661 of the Acts 1983) with a mandate to accumulate assets through investment earnings and other revenue sources in order to reduce the Commonwealth's significant unfunded pension liability, and to assist local participating retirement systems in meeting their future pension obligations. The PRIT Fund merged with the Massachusetts State Teachers' and Employees' Retirement System ("MASTERS") Trust on January 1, 1997, in accordance with Chapter 315 of the Acts of 1996. As of June 30, 2004, the net assets of the PRIT Fund totaled approximately \$32 billion. The Trustees of PRIM (the "Trustees") are charged with the general supervision of the PRIT Fund.

Pursuant to M.G.L. ch. 32, sec. 23(2A)(e), the Trustees, as fiduciaries for each retirement system that invests in the PRIT Fund, have authority to employ an Executive Director, outside investment managers, custodians, consultants, and other professionals they deem necessary to formulate policies and procedures and to take other actions as deemed necessary and appropriate to manage the assets of the PRIT Fund. As trustees of the PRIT Fund, the Trustees are fiduciaries. Accordingly, under M.G.L. ch.32 sec. 23, the Trustees are required to:

1. Act solely in the interest of the participating retirement systems' participants and beneficiaries, for the exclusive purpose of providing benefits and defraying the reasonable costs of managing the systems' pension assets.
2. Act with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.
3. Diversify the investments of the PRIT Fund in order to minimize the risks of large losses unless under the circumstances it is clearly prudent not to do so.
4. Act in accordance with the PRIT Fund's authorizing statute and governing documents

Pension Reserves Investment Management Board

NOTES TO FINANCIAL STATEMENTS (Continued)

FOR THE FOUR YEAR PERIOD ENDING JUNE 30, 2004

Pursuant to G.L. c. 32 § 1, fiduciary standards of conduct also apply to PRIM's staff, investment managers, custodians, investment consultants, and others who exercise discretionary authority or discretionary control over the management or disposition of PRIT Fund assets. The Trustees are responsible for establishing the policies and guidelines by which the PRIT Fund is managed and PRIM is operated.

To assist the Trustees in carrying out their duties, they have established four standing committees as described below. Pursuant to the By-Laws of the Massachusetts PRIM, Article II, sec. 8, the role of each committee is to make recommendations to the Trustees within its stated area of responsibility. Members of the committees shall be appointed by the chairperson after consultation with other Trustees and shall be ratified by a vote of the Trustees. Such committees may include, at the option of the Trustees, members who are not Trustees (such as representatives from PRIM's participating and purchasing systems).

Administration Committee. The Administration Committee reviews all issues related to the administration of PRIM. The Committee's responsibilities include but are not limited to: recommending amendments to the PRIT Fund's Operating Trust and the By-Laws of PRIM; authorizing and eliminating staff positions; establishing a staff salary structure; conducting Executive Director evaluations; and overseeing the custodian of the PRIT Fund's assets, the PRIM operating budget and financial statements, staff and trustee travel, and office management.

Audit Committee. The Audit Committee oversees the annual audits of the PRIT Fund and PRIM, including the selection and hiring of auditors, the review of the completed audits, and the PRIM staff's responses to auditors' findings.

Investment Committee. The Investment Committee reviews all investment-related policy, performance, and management issues. The Investment Committee reviews and recommends to the Trustees the broad asset allocation among various asset classes. For all asset classes other than real estate, the committee also reviews and recommends investment structure, recommends hiring and terminating investment managers and consultants, and monitors investment performance.

Real Estate Committee. The Real Estate Committee reviews all policy, performance and management issues related to investment in real estate. The Real Estate Committee reviews and recommends to the Trustees the structure of the real estate asset class, hiring and terminating real estate investment managers and consultants, and acquiring or disposing of properties where this authority is not delegated to another fiduciary. The Real Estate Committee also monitors real estate investment results and real estate manager performance and organizational issues.

Pension Reserves Investment Management Board

NOTES TO FINANCIAL STATEMENTS (Continued)

FOR THE FOUR YEAR PERIOD ENDING JUNE 30, 2004

The Executive Director, with the assistance of PRIM staff, has the responsibility and authority to assist the Trustees and their committees in establishing investment and administrative policy; to implement the policies and programs established by the Trustees; and to report to the Trustees on the status of the PRIT Fund and the operations of PRIM.

The Trustees employ professional investment managers and give them discretion, consistent with specified objectives and guidelines, to manage the PRIT Fund's assets. The Trustees and PRIM staff do not directly manage any PRIT Fund portfolios. Each investment manager operates under a formal contract that delineates responsibilities and performance expectations, including formal investment guidelines and administrative requirements for each portfolio. The Trustees review the investment performance of all managers against their stated objectives at least quarterly.

The Trustees may utilize the services of one or more investment management consultants to assist the Trustees and PRIM staff in performance review, asset allocation studies, investment structure analyses, manager screening and selection, investment research and other matters of investment policy, procedures, and implementation. The analysis and recommendations of the consultants may be considered by the Trustees in conjunction with other available information for the purpose of making informed and prudent decisions.

The Trustees may retain one or more custodian banks or trust institutions to hold the assets of the PRIT Fund. The custodian accounts for and assists in the settlement of all transactions executed by PRIM's investment managers and makes available to the Trustees and to PRIM staff information with respect to the holdings, transactions, and performance of the PRIT Fund. Currently custodian services are provided by Mellon Bank.

The Trustees may utilize the services of independent auditors, appraisers and other third parties, as needed. Currently, the annual audit is provided by KPMG.

PRIM's mission is to maximize the return on investment within acceptable levels of risk by broadly diversifying the PRIT Fund's investment portfolio, capitalizing on economies of scale to achieve cost-effective operations, and providing access to high quality, innovative investment management firms, all under the management of a professional staff and the Trustees.

PERAC

Five Middlesex Avenue | Third Floor

Somerville, MA | 02145

Ph: 617.666.4446 | Fax: 617.628.4002

TTY: 617.591.8917 | Web: www.mass.gov/perac